

# NEWS

## SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

(202) 755-4846



HOLD FOR 1:00 P.M. RELEASE, THURSDAY, JANUARY 24, 1974

### THE EMERGING RESPONSIBILITIES OF THE SECURITIES LAWYER

An Address By

A. A. Sommer, Jr., Commissioner

Securities and Exchange Commission

Banking Corporation and  
Business Law Section  
New York State Bar Association  
New York Hilton Hotel  
New York, New York

January 24, 1974

## THE EMERGING RESPONSIBILITIES OF THE SECURITIES LAWYER

A. A. SOMMER, JR. \*  
Commissioner  
Securities and Exchange Commission  
Washington, D. C.

For many years the sponsors of securities institutes and programs have been blessed with innumerable occasions to promote their wares: attorneys have flocked to programs on Rule 10b-5, then the Texas Gulf Sulphur complaint (at this point we all ceased to wait for the decisions and spent endless hours and days discussing simply the charges) was the focus, then Bar Chris, accountants' liabilities, and innumerable subtopics and variations of these. All of these and others have now been subordinated in interest to a single topic: the legal exposures of lawyers under the securities laws administered by the Securities and Exchange Commission. Anyone organizing a program to which he expects to entice lawyers in substantial numbers cannot safely omit this topic. The topic is, in the vernacular, hot, a best seller.

The event which triggered this interest, of course, was the filing of the complaint by the Commission against National Student Marketing Corp., its accountants, several of its executives, and most importantly from the standpoint of attorneys, two outstanding and prestigious law firms, one in New York, and the other in Chicago, and partners in the firms.

It was not just the filing of a complaint naming attorneys that triggered this intense and tense interest, for, after all, other attorneys had been named in Commission complaints, frequently because of conduct during their representations of clients and not because of other roles -- director, officer, and so on. Clearly, the interest was heightened by the fact that for the first time old firms of recognized competence and integrity were named as defendants. I think many attorneys had read the travails of other less

---

\* The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or speech by any of its members or employees. The views expressed here are my own and do not necessarily reflect the views of the Commission or of my fellow Commissioners.

well-known counsel with the thought that these were not really relevant because of their obscurity and the absence of recognition of their firms as expert and knowledgeable, whereas the naming of firms of national prominence hinted that no one was immune. Everyone who worked in securities law suddenly felt vulnerable and exposed. Lawyers began to experience the trepidation and concern and uneasiness that began to afflict their accounting brethren many years ago as they began to realize that prestige, name, proud history, did not afford immunity against civil and even criminal action.

It is something of an understatement to say that the complaint in National Student Marketing had excited lively interest in the legal profession. Innumerable articles, notes, student comments, lectures have now been published analyzing the complaint, discussing the applicable law, proposing means of swiftly eliminating the queasiness in the collective stomach of the securities bar.

The apprehension of securities and corporate attorneys was, of course, increased by the complaint in the Vesco case which, while not naming a firm, nonetheless named attorneys associated with a prominent firm. And another measure of disturbance was added when the Court of Appeals for the Second Circuit in the Spectrum case suggested that simple negligence in the rendering of an opinion concerning exemption from registration might expose counsel at least to Commission injunctive action.

It would not, I'm sure you realize, be appropriate for me to comment on any of this pending litigation or say anything which would sound like prejudgment, or argument of the case, or suggestion to the various courts

involved of the manner in which they should view these charges. And it is not my purpose to discuss at length the legal theories concerning counsel liability, the subtleties of the Code of Professional Responsibility and its relationship to the problem; the sources on these matters are plentiful. However, I think I can with propriety discuss the milieu, if you will, in which these cases arise, some of the broader implications of them, and make a few very personal observations concerning their significance.

Attorneys have since the earliest days of the federal securities laws been at the heart of the scheme that developed in response to those laws. While their formal participation mandated by the '33 and '34 Acts was limited -- the only reference to counsel was in Item (23) of Schedule A to the 1933 Act which required the inclusion in registration statements of "the names and addresses of counsel who have passed on the legality of the issue . . ." -- nonetheless, the registration statement has always been a lawyer's document and with very, very rare exceptions the attorney has been the field marshall who coordinated the activities of others engaged in the registration process, wrote (or at least rewrote) most of the statement, made the judgments with regard to the inclusion or exclusion of information on the grounds of materiality, compliance with registration form requirements, necessities of avoiding omission of disclosure necessary to make those matters stated not misleading. The auditors have been able to point to clearly identifiable parts of the registration statements as their responsibility and they have successfully warded off efforts to extend their responsibility beyond the financial statements with respect to which they opine. With the exception of the financial statements, virtually everything else in the registration statement bears the imprint of counsel.

Counsel have been involved in many other ways with the federal securities laws. They are frequently called upon to give opinions with respect, principally, to the availability of exemptions from the requirements for registration and use of a statutory prospectus. None would deny the importance of these opinions: millions upon millions of dollars of securities have been put into the channels of commerce -- not just sold once, but permanently into the trading markets -- in reliance upon little more than the professional judgment of an attorney. In many, perhaps most, instances these opinions have been confined to questions concerning the technical availability of the exemption and have not been concerned with questions of disclosure, compliance with the somewhat amorphous mandates of Rule 10b-5 and other anti-fraud provisions of the federal securities laws.

Attorneys' opinions have played other roles as well. They are customarily rendered in connection with the closing of registered public offerings, both by issuer and underwriter counsel, and in those opinions conclusions with respect to disclosure begin to emerge. In opining that a registration statement complies as to "form" with the requirements of the Securities Act of 1933, often counsel may be saying more about the contents of the statement than he realizes and if his opinion goes to the question of the legality of the offering as distinguished from the securities, certainly clear questions concerning the adequacy of disclosure are raised.

Of course, the attorney appears in many other contexts: often he appears in court or before the Commission as an advocate in formal proceedings; his advocacy may also be discerned in various discussions with the staff. For the moment I would put those matters aside and suggest that the resolution of

the responsibilities of the advocate, as distinguished from the counselor, registration statement writer and opinion giver, are somewhat more amenable to resolution with traditional notions.

In a word, and the word is Professor Morgan Shipman's, the professional judgment of the attorney is often the "passkey" to securities transactions. If he gives an opinion that an exemption is available, securities get sold; if he doesn't give the opinion, they don't get sold. If he judges that certain information must be included in a registration statement, it gets included (unless the client seeks other counsel or the attorney crumbles under the weight of client pressure); if he concludes it need not be included, it doesn't get included.

Securities lawyers have since the adoption of the 1933 Act stoutly urged that they play a limited role in this process, even to the point of continuing to insist, despite the requirement of Form S-1, among others, that there be submitted as a part of the registration statement an opinion of counsel concerning the legality of the securities being registered, that they are in no way "experts" within the meaning of Section 11. Beyond that, they have gloried in the occasional judicial acknowledgment of the limitations of their role. How often have we been reminded that in Escott v. BarChris Judge McLean specifically rejected the suggestion that the attorneys involved in the preparation of the contested registration statement were experts with respect to all of it except the financial statements and concluded that some of the attorneys had liability only because of their roles as director and officer of the issuer?

We are consistently reminded that historically the attorney has been an advocate, that his professional ethics have over the years defined his function in those terms, that such a role includes unremitting loyalty to the interests of his client (short of engaging in or countenancing fraud). Whenever the effort is made to analogize the responsibilities of the attorney to those of the independent auditor, one is reminded that the federal securities law system conceives of the auditor as independent and defines his role specifically, whereas the attorney is not and cannot be independent in the same sense in which an auditor is independent. It has been asserted by very eminent counsel that, "The law, so far, [this was in 1969] is very clear. The lawyers' responsibility is exclusively to their own client." If this distinction is clear to lawyers, it is less clear to others.

I would suggest that the security bar's conception of its role too sharply contrasts with the reality of its role in the securities process to escape notice and attention -- and in such situations the reality eventually prevails. Lawyers are not paid in the amounts they are to put the representations of their clients in good English, or give opinions which assume a pure state of facts upon which any third year law student could confidently express an opinion.

We live in the age of the consumer. All of the old articles of faith which frustrated him in efforts to achieve equity have fallen or are

falling; cognovit notes are repudiated in most places; the sale of installment paper no longer immunizes the paper purchaser from responsibility for the shoddiness of the merchandise; people pressured into purchases on their doorstep have time to think over their decision; the real costs of borrowing and purchases on installments must be disclosed. This pervading judicial and legislative concern for the interests of the consumer which has for forty years been present in large measure in the securities field (the securities laws may have been the first federal consumer legislation) is affecting and will affect increasingly the securities field -- and those involved in it.

Consequently, I would suggest that all the old verities and truisms about attorneys and their roles are in question and in jeopardy -- and, unless you are ineradicably dedicated to the preservation of the past, that is not all bad.

I would suggest that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. This means several things. It means he will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means he will have to adopt the healthy skepticism toward the representations of management which a good auditor must adopt. It means he will have to do the same thing the auditor does when confronted with an intransigent client -- resign.

This may seem shocking to many ears, but I would suggest that these conclusions are already implicit in what the courts and the Commission have already said; more important, their foundations lie deep in the past.

As long ago as 1934 William O. Douglas lamented an absence of social-mindedness in business lawyers and opined that this was "evidenced by the almost perverted singleness of purpose with which they have championed the cause of their clients, whether it be in the drafting of a deposit agreement, the handling of a merger, the conduct of a reorganization, or the marketing of securities. It resulted in getting accomplished what clients wanted but without regard for the long-term consequences of those accomplishments. That singleness of purpose has been wholly incompatible with the use of these aggregations of capital for either the welfare of the investor or for the good of the public . . ."

More recently, the Court of Appeals for the Second Circuit in 1964 said the familiar words, "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."

Two years earlier the Commission, in discussing the practices of attorneys in rendering opinions concerning securities matters, said:

"An attorney's opinion based upon hypothetical facts is worthless if the facts are not as specified, or if unspecified but vital facts are not considered. Because of this, it is the practice of responsible counsel not to furnish an opinion concerning . . . the availability of an exemption from registration . . . unless such counsel have themselves carefully examined all of the relevant circumstances and satisfied themselves, to the extent possible, that the contemplated transaction is, in fact, not a part of an unlawful distribution."

Another manifestation of the trends of the law with respect to the role of lawyers is, in my estimation, clearly discerned in the case which has

been a consolation to many, the BarChris case. The outside counsel for the company was sued as a director of the company under Section 11 of the 1933 Act and the court made clear that its determination of his liability was as a director. But the discussion by the court of his liability is interesting: it all relates to his activities as lawyer in the preparation of the registration statement. For instance, the court said:

"It is claimed that a lawyer [note the court says lawyer, not director] is entitled to rely on the statements of his client and that to require him to verify their accuracy would set an unreasonably high standard. This is too broad a generalization. It is all a matter of degree. To require an audit would obviously be unreasonable. On the other hand, to require a check of matters easily verifiable is not unreasonable. Even honest clients make mistakes."

I would suggest that had this director been sued qua lawyer under Rule 10b-5, the court would have reached the same conclusion for the same reasons. Implicit in the language of the court is the thought that a lawyer preparing a registration statement has an obligation to do more than simply act as the blind scrivener of the thoughts of his client.

Quite obviously the implications of the cases being decided and the convictions of the Commission being expressed through complaints which it files, even though, as I suggest, these are but manifestations of broad social trends, raise a host of questions concerning the manner in which attorneys should conduct their representation of clients. How does this affect the traditional attorney-client privilege? Does it undermine the relationship of confidence between attorney and client that has been so important to the bar in doing its work? Must the attorney "welsh" on his client when he discerns an illegal direction to his activities? Must the attorney, in short, become another cop on the beat?

I would not suggest that the resolution of these problems is easy. The resolution will entail close study of the emerging case law, attention to the Code of Professional Responsibility, alertness to the demands of society upon the professionals it employees, and recognition of the pivotal role of counsel in the process by which securities are brought to market.

I would suggest that the bar will make a serious error if it seeks to defend itself against the emerging trends by reliance upon old shibboleths and axioms. Society will not stand for it, any more than it will stand for the accounting profession saying that all it does is determine whether financial statements are prepared in accordance with generally accepted accounting principles and that it has no professional concern with their overall fairness or the adequacy of their portrayal of economic reality. Everyone has been shocked by the massive betrayal of public investors in recent years and inevitably the focus is upon the people and the process through which these debacles came about. This spotlight will, I predict, increasingly focus upon the role of attorney who is invariably a keeper of the stop and go signal.

I would not have you understand that I believe the attorney must become the guarantor of his client's probity any more than I would suggest that the auditor is the guarantor of the accuracy of his client's financial statements. Attorneys and auditors can be the victims of unprincipled clients as can the public and even regulatory agencies. And I would not suggest that whenever there is a financial collapse there is necessarily or invariably involved derelictions on the part of the attorney or auditor. But I do suggest that the role of the attorney, the conduct of the attorney, the competence of the attorney, the integrity of the attorney, and yes, in some measure, the independence of the attorney will be increasingly scrutinized.

The recent actions of the Commission have produced rampant uncertainty in the ranks of securities lawyers. Out of this uncertainty have come a number of proposals. When I was Chairman of the ABA Corporation, Banking and Business Law Section's Committee on Federal Regulation of Securities I assisted in initiating an effort by the bar to establish some standards of conduct for the guidance of securities and corporate lawyers. Professor Morgan Shipman of Ohio State has suggested imaginative rule-making by the Commission as the means of abating this gnawing uncertainty. Others have suggested that the Commission should simply declare that the attorneys are experts with respect to entire contents of the registration statement other than the financial statements, thus affording them the certainties, if such they be, of Section 11 of the Securities Act of 1933 and its system of defenses.

I doubt if the Commission can or should engage in rule-making directed toward easing the worries of the bar; I would have some doubt whether the resulting rules would accomplish as much as it is hoped they would. Similarly, I am loathe to impose upon the bar by administrative action something as awesome as Section 11 liability with respect to the entire contents of the registration statement when there is no evidence of any such intention on the part of Congress when it adopted the statute, though I must confess, it seems to me the implications of the BarChris case point in that direction, not as a consequence of Section 11, but rather of Rule 10b-5.

I would hope -- and perhaps this hope, given my lack of confidence in the other approaches, is the consequence of some pride of parentage -- that the private bar will move to eliminate some of the uncertainty. The success of their effort will in large measure be measured, in my estimation, by their

responsiveness to the fact that society is pricking out a new and broader responsibility for everyone involved in the securities markets, including attorneys.

Notwithstanding the efforts of the private bar and others to alleviate the uncertainties of the members of the bar who practice securities law, notwithstanding the discomfort and dangers of cancelled and sharply restricted insurance policies, I cannot help but conclude somewhat pessimistically that there will be several years ahead before the clouds begin to separate and the outlines of the landscape amid which we will practice for the remainder of our lives become clear. Society in general, the securities law in particular, is in a period of revolution and usually efforts to hasten the conclusion of a revolution are unavailing. The courts, and to some extent the Commission, are the conduits through which the forces causing change bring it about -- and these instrumentalities move somewhat cautiously -- case by case, problem by problem.

I think, though, enough guidelines can be found in court opinions, the writings of competent writers, the emerging convictions of practitioners to allay some of the more frightening uncertainties. I would not attempt to delineate them in any greater detail other than to suggest that increasingly the attorney involved in the securities marketing process must be alert to the interests of the public and recognize the critical importance of his role in determining whether that public is treated fairly or not.

The Commission cannot remain quiescent in the face of the changes of our society and the demands which that society is making on all those who occupy positions of responsibility and learning. Furthermore, the Commission has

the responsibility of constantly reexamining the standards which it demands of those involved in securities matters so that the interests of investors can be steadily advanced. Thus, conduct which might have been tolerable in other ages becomes unacceptable in these times. The accountants' conduct clearly comes under new, more urgent, more searching scrutiny. The standards by which directors carry out their responsibilities in publicly-held companies are similarly undergoing critical reexamination. It is not given to any group in society, and certainly not lawyers, to be insulated from the trends.

However, the Commission and its staff must be cautious in the steps it takes in realizing this enhancement of responsibility. All of us know of the dramatic and unfortunate impact any litigation questioning the conduct of a professional can have on his career, as well as his finances. Corporations can withstand legal attacks and go forward to thrive and not infrequently corporate executives can do the same. However, it is far more difficult for a professional to retain his community standing, his self-respect and his financial security after questions have been raised publicly concerning his integrity or his competence. The Commission and its staff must be extremely cautious when it is confronted with a seeming involvement of counsel in securities misconduct. It is too easy, too tempting to believe that an attorney always has knowledge or awareness sufficient to rouse inquiry into the misshapen schemes of his client. It is too facile to conclude that the presence of counsel is a necessary ingredient of every witches' brew. It is too easy to confuse vigorous, even commendable, representation of a client with countenancing misconduct. Before the Commission files a complaint, institutes a Rule 2(e) proceeding or makes a

criminal reference, it must be as certain as it can be that it is not confusing counsel diligence for counsel coverup, that it does not demand a standard of conduct beyond that which can reasonably be expected of professionals. I am pleased to say that in the relatively brief time I have been at the Commission we have in cases suggesting misconduct on the part of attorneys (and, I might add, all proposed respondents) exercised this measure of diligent examination and in several instances refused to bring action involving professionals even though at first glance their culpability seemed apparent.

I realize that caution on the part of the Commission may not be sufficient; there still exists the possibility of civil suits for damages. Very frequently, these are the consequence of initiatives of the Commission; consequently, if the Commission does not take action in a given situation, the possibility of other civil litigation is substantially reduced. There is little the Commission can do to mitigate the rigors of such suits for attorneys and I recognize that it is difficult for counsel to accept with any complacency the possibility of ruinous damages. We would all hope that counsel for would-be civil litigants would exercise a degree of responsibility which I believe the Commission does, but that may be too sanguine an expectation. It is also scant consolation to the legal profession to suggest that the fear of civil liability and the imposition of money damages has throughout the history of our legal system been a deterrent against misconduct and has generally had the effect of raising professional and other standards of conduct. And, yet, that is so, and I am sure that it will have the same effect with respect to those who practice that variety of law called securities law.

One further thought with regard to damage suits that I think bears considerable merit, namely, that the assertions of damages under our present

rules which may potentially be assessed against attorneys and others involved in the securities process are grossly unrealistic and that something should be done to moderate the potential severity of these standards of measurement. As many of you I am sure are aware, the proposed Federal Securities Code, of which Louis Loss is the reporter, does contain in the current drafts limits upon the damages for which attorneys, among others, may be held liable absent direct gain or high degree of fault. Perhaps circumstances require that efforts to develop realistic limits be deferred until the Code is ready for submission to Congress. I think when it is submitted to Congress the bar should concern itself very deeply with this issue. I would urge, however, that it not propose or promote too stringent limitations, otherwise Congress will regard its efforts as excessively parochial and self-serving.

I would suggest that the sort of reexamination of the historic role of counsel is not inconsistent with the broader responsibilities of the bar to its clients. Much of what I have said was expressed in the Preface of the American Bar Association's Code of Professional Responsibility:

"Before the Bar can function at all as a guardian of the public interests committed to its care, there must be appraisal and comprehension of the new conditions, and the changed relationship of the lawyer to his clients, to his professional brethren and to the public. That appraisal must pass beyond the petty details of form and manners which have been so largely the subject of our Codes of Ethics, to more fundamental consideration of the way in which our professional activities affect the welfare of society as a whole. Our canons of ethics for the most part are generalizations designed for an earlier era."

I would urge that as lawyers we not be hesitant in representing our clients, but let us not be hesitant, either, in protecting those who rely, sometimes rather blindly, upon the protections of professional judgment.